What is mortgage insurance and how does it work?

Answer: Mortgage insurance lowers the risk to the lender of making a loan to you, so you can qualify for a loan that you might not otherwise be able to get.

Typically, borrowers making a down payment of less than 20 percent of the purchase price of the home will need to pay for mortgage insurance. Mortgage insurance lowers the risk to the lender of making a loan to you, so you can qualify for a loan that you might not otherwise be able to get. But, it increases the cost of your loan. If you are required to pay mortgage insurance, it will be included in your total monthly payment that you make to your lender, your costs at closing, or both.

WARNING:

Mortgage insurance, no matter what kind, protects the lender – not you – in the event that you fall behind on your payments. If you fall behind, your credit score may suffer and you can lose your home through foreclosure.

There are several different kinds of loans available to borrowers with low down payments. Depending on what kind of loan you get, you'll pay for mortgage insurance in different ways:

If you get a conventional loan, your lender will arrange for mortgage insurance with a private company. Private mortgage insurance rates vary by down payment amount and credit score but are generally cheaper than FHA rates for borrowers with good credit. Most private mortgage insurance is paid monthly, with little or no initial payment required at closing.

If you get a Federal Housing Administration (FHA) loan, your mortgage insurance premiums are paid to the Federal Housing Administration (FHA). FHA mortgage insurance is required for all FHA loans. It costs the same no matter your credit score, with only a slight increase in price for down payments less than five percent. FHA mortgage insurance includes both an upfront cost, paid as part of your closing costs, and a monthly cost, included in your monthly payment.

If you don't have enough cash on hand to pay the upfront fee, you are allowed to roll the fee into your mortgage instead of paying it out of pocket. If you do this, your loan amount and the overall cost of your loan will increase.

If you get a US Department of Agriculture (USDA) loan, the program is similar to the Federal Housing Administration, but typically cheaper. You'll pay for the insurance both at closing and as part of your monthly payment. Like with FHA loans, you can roll the upfront portion of the insurance premium into your mortgage instead of paying it out of pocket, but doing so increases both your loan amount and your overall costs.

If you get a Department of Veterans' Affairs (VA) loan, the VA guarantee replaces mortgage insurance, and functions similarly. With VA loans, there is no monthly mortgage insurance premium. However, you will pay an upfront "funding fee." The amount of that fee varies based on:

- Your type of military service
- Your down payment amount
- Your disability status
- Whether you're buying a home or refinancing
- Whether this is your first VA loan, or you've had a VA loan before

Like with FHA and USDA loans, you can roll the upfront fee into your mortgage instead of paying it out of pocket, but doing so increases both your loan amount and your overall costs.